


# ***PR 2001/90 - Income tax: Exotic Timbers of Australia NT3 Project***

 This cover sheet is provided for information only. It does not form part of *PR 2001/90 - Income tax: Exotic Timbers of Australia NT3 Project*

 This document has changed over time. This is a consolidated version of the ruling which was published on *20 June 2001*



## Product Ruling

### Income tax: Exotic Timbers of Australia NT3 Project

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Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

#### **Preamble**

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

#### **No guarantee of commercial success**

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The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

#### **Terms of Use of this Product Ruling**

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This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Exotic Timbers of Australia NT3 Project, ETA NT3, or simply as 'the Project'.

### Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - section 8-1 (ITAA 1997);
  - section 17-5 (ITAA 1997);
  - Division 27 (ITAA 1997);
  - Division 35 (ITAA 1997);
  - section 42-15 (ITAA 1997);
  - Part 2-25 (ITAA 1997);
  - section 387-125 (ITAA 1997);
  - section 387-165 (ITAA 1997);
  - section 82KL of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - section 82KZL (ITAA 1936);
  - section 82KZM (ITAA 1936);
  - sections 82KZMA - 82KZMF (ITAA 1936); and
  - Part IVA (ITAA 1936).

### Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered, for GST and hold a valid tax invoice.

**Business Tax Reform**

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

**Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

**Class of persons**

7. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

**Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling.

10. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at paragraphs 15 to 48) is carried out in accordance with details described in the Ruling.

If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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## Date of effect

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12. This Ruling applies prospectively from 20 June 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a taxation dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

13. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

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14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

15. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- Application for Product Ruling dated 23 February 2001;
- **Draft Prospectus for Exotic Timbers of Australia NT3 Project prepared and issued by Exotic Timbers of Australia Limited (“the Responsible Entity”), not dated;**
- **Licence and Management Agreement between Exotic Timbers of Australia Limited (“the Manager”) and the Grower, dated 14 May 2001;**
- **Constitution for Exotic Timbers of Australia NT3 Project between Exotic Timbers of Australia Limited (“the Responsible Entity”) and the Grower, dated 14 May 2001;**
- Compliance Plan for Exotic Timbers of Australia NT3 Project adopted by Exotic Timbers of Australia Limited as ‘the Responsible Entity’, dated 26 April 2001;
- Custodian Agreement between Exotic Timbers of Australia Limited (“the Responsible Entity”) and the Custodian, dated 17 April 2001;
- Northern Territory of Australia Memorandum of Lease between the land owner (“the Lessor”) and Exotic Timbers of Australia Limited (“the Lessee”), not dated;
- Constitution of Integrated Oil Extractions N. T. Limited, dated 29 January 2001;
- Northern Territory of Australia Memorandum of Lease between Exotic Timbers of Australia Limited (the Lessor) and Integrated Oil Extractions N. T. Limited (the Lessee), not dated; and
- Additional correspondence dated or received 20 April 2001, 23 April 2001, 2 May 2001, 7 May 2001, 15 May 2001, 23 May 2001, 28 May 2001, 31 May 2001, 7 June 2001, 8 June 2001 and 11 June 2001.

**Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.**

16. The documents highlighted are those that Growers may enter into. For the purposes of describing the arrangement to which this

**PR 2001/90**

Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of a Grower, will be a party to, which are a part of the arrangement. The effect of this agreement is summarised as follows.

**Overview**

17. The arrangement is called the Exotic Timbers of Australia NT3 Project.

Responsible Entity	Exotic Timbers of Australia Limited Suite 39 12 Charlton Crescent Stuart Park Darwin NT 0820
Type of business each participant is carrying on	Long term commercial growth and cultivation of Sandalwood, Neem, Mahogany and Melia Azedarach trees for the purpose of producing timber, prunings, seeds and leaves.
Location	Approximately 100 km south of Darwin in the Northern Territory
Number of hectares offered for cultivation	This Prospectus provides for up to 135 hectares to be planted
Possible total subscription	3000 Woodlots
Size of each Woodlot	0.045 hectares (450m <sup>2</sup> )
Minimum investment	1 Woodlot
Minimum subscription for Project	100 Woodlots
Number of trees established per hectare	741 Sandalwood per hectare; 741 Neem per hectare; 556 Mahogany per hectare; and 404 Melia Azedarach per hectare.
The term of the investment	16 years
Initial Cost	\$5,500
Initial costs per hectare	\$122,222
Ongoing costs	Management Fees payable to the Manager for performing the Woodlot services during the relevant years. Woodlot Rent. Insurance. Harvesting, Marketing and Sales Costs.
Other costs	Purchase shares in Land Company at a cost of \$1,000

18. Growers applying under this Prospectus join in either the year ending 30 June 2001 or the year ending 30 June 2002 depending on their date of application. The date of application also determines the date of execution of the Licence and Management Agreement and the period of provision of services to be performed in the first year to which the Application Moneys relate. The relevant application periods are summarised as follows:

<b>Application lodged</b>	<b>Grower</b>	<b>Date of Execution</b>	<b>Total Application Moneys</b>	<b>Period of provision of the Initial Period Services</b>
On or before 22/6/2001	Year 2001 Growers	on or before 22/6/2001	\$5,500	From date of execution of Licence and Management Agreement to 30/6/2001.
On or after 23/6/2001	Year 2002 Growers	at any time between 1/7/2001 and the date the Prospectus expires (inclusive)	\$5,500	From date of execution of Licence and Management Agreement to 30/6/2002.

19. The Project is to carry out a large scale planting of Sandalwood, Neem, Central American Mahogany and Melia Azedarach trees upon land to be held by the Manager. The Project is for a period of sixteen years.

20. Growers will enter into a Licence and Management Agreement between Exotic Timbers of Australia Limited (ETA) (as the Manager) and the Grower. This agreement is set out in the Schedule to the Constitution. The Agreement provides for the Licence of a Property, located 100 kilometres south of Darwin, being the property situated at Lot 196 Batchelor Road, Batchelor, in the Northern Territory.

21. The Licence and Management Agreement gives a Grower a Licence from the Manager over an identifiable area of land called a Woodlot until the Project is terminated pursuant to the provisions of the agreement or on 30 June 2016, whichever happens first.

22. The Grower engages ETA to carry out the management of their Woodlot. ETA will establish and cultivate a multi species plantation consisting of Sandalwood, Mahogany, Neem and Melia



Azedarach and be responsible for maintaining, harvesting, marketing and selling the Crop from the Woodlot. Growers may elect, on a yearly basis, to undertake the harvest and sale of the Grower's Product by giving written notice to the Manager (clause 9). Where the Grower elects to appoint the Manager to undertake the harvest and sale of the Grower's Product the Grower accepts the minimum price specified in the harvest notice as the lowest price for which the Manager is authorised to sell the Product (clause 9.3).

23. Under the Prospectus, ETA proposes to offer a maximum of 3,000 Woodlots. There is a minimum subscription for the Project of 100 Woodlots. Should minimum subscription not be reached the project will not proceed and application monies will be returned to investors. The minimum individual holding is one Woodlot, being an allotment of 0.045 hectares of land, which will be planted with 15 Sandalwood and such host plants as may facilitate the growth of the Sandalwood trees, 8 Neem, 6 Central American Mahogany and 1 Melia Azedarach. Each Woodlot will consist of two Sub-Woodlot units. The first Sub-Woodlot unit will comprise of a double row of eight and seven Sandalwood Trees alternating with a row of eight Neem trees. The second Sub-Woodlot will comprise of a single row of six Mahogany Trees and one Melia Azedarach. Woodlots are allocated by ETA who shall maintain an up to date register of Growers, identifying the Woodlots held by Growers.

24. The date of the Grower's application determines the date of execution of the Licence and Management Agreement and the period of provision of services to which the first year fees relate. Subscriptions for the Project will be accepted until the Prospectus expires, but Applications received on or after 23 June 2001 will not be executed until 1 July 2001.

25. Possible projected returns for Growers are outlined in the Draft Prospectus. The Sandalwood and Mahogany will be harvested for their wood in the 16<sup>th</sup> year. The Neem and Melia Azedarach trees are grown for the harvest of their leaves, prunings and fruit. The Draft Prospectus states that the Project is a mature term forestry venture and is subject to the risks and liabilities attendant on such projects. ETA has outlined the risks in the Draft Prospectus and has stated that participation in the Project is intended to be of a long term nature, therefore subject to the attendant risks and should be considered speculative. Growers will execute a Power of Attorney enabling the ETA to act on their behalf as required when they make an application for a Woodlot.

26. Each Grower must also subscribe for 1,000 shares in Integrated Oil Extractions N. T. Limited (IOE).

**Constitution**

27. The relevant Constitution establishes the Project and operates as a deed binding on all of the Growers of the Project and the Responsible Entity. The Constitution sets out the terms and conditions under which ETA agrees to act as Responsible Entity and thereby manage the Project. The Licence and Management Agreement is annexed to the Constitution and will be executed on behalf of a Grower following them signing the Application and a Power of Attorney Form in the Prospectus. Growers are bound by the Constitution by virtue of their participation in the Project. Pursuant to clause 14 of the Constitution, the Responsible Entity will keep a register of Growers. Growers may assign their interest only in certain circumstances as set out in clause 17 of the Constitution.

**Compliance plan**

28. The Responsible Entity has prepared a Compliance Plan in accordance with the Corporations Law. The Compliance Plan's purpose is to ensure that the Responsible Entity manages the Project in accordance with its obligations and responsibilities contained in the Constitution and that the interests of Growers are protected.

**Lease**

29. The Lease Agreement has been entered into between the landowner and ETA. Under the Agreement the Lessor grants a Lease to the Lessee. The term of the Lease is 20 years, with the term of the Lease commencing on 1 January 2001. The Lease allows the Lessee to enter into Agreements to sub-let up to 3,000 lots of approximately 450m<sup>2</sup> to Growers for the purposes of establishing the Project.

**Licence and Management Agreement**

30. The Licence and Management Agreement sets out the roles and obligations of the parties to the Agreement. The Agreement is entered into between ETA as the Manager and the Grower. Under the terms of the Agreement the Grower may only use the Land for the purpose of growing and developing the Seedlings and harvesting the Crop from the Plantation. Under the Agreement the Manager grants a Licence to the Grower and the Grower appoints the Manager to establish, maintain, harvest and sell the Product on the Grower's Woodlot.

31. The agreement commences on the date the Grower's Licence and Management Agreement is executed by the Responsible Entity.

The Project is terminated pursuant to the provisions of the agreement or on 30 June 2016 (clause 14).

32. Growers participating in the Project are granted an interest in land by the Manager in the form of a licence to use their Woodlot for the purpose of conducting a long-term business of cultivating Sandalwood, Mahogany, Neem and Melia Azedarach for the production of Product for sale.

33. Each Grower must pay rent to the Manager being an amount as specified in clause 3 of the Licence and Management Agreement.

34. Under the terms of the Licence and Management Agreement, among other things, the Grower:

- must not permit any activity on the Woodlot which may be detrimental to the Project or the Crop; and
- shall not assign, transfer, sub-let or part with possession of the Woodlot without obtaining prior written consent from the Manager.

35. Under the terms of the Licence and Management Agreement the Manager must, amongst other things, identify and maintain the identity of the Woodlots by marked survey disks located by global positioning satellite.

36. The Licence and Management Agreement provides that each Grower appoints the Manager to perform services under the Agreement. The services to be performed are specified at clause 6 of the Agreement. The Manager will supervise and perform all agro-forestry activities to be carried out on the Woodlot on behalf of the Grower including, but not limited to the provision of the following services:

- supply and nurture the Seedlings;
- plant the Seedlings not later than 7 months after the execution of the Licence and Management Agreement;
- establish and maintain an irrigation system on the Woodlot;
- establish and maintain suitable access to each Woodlot;
- establish and maintain a pest and weed control program;
- maintain all fire breaks;
- provide general care and maintenance to the Woodlot;
- arrange for the harvesting of the Product; and
- arrange for the sale of Product from the Woodlot.

37. ETA will plant the seedlings not later than 7 months after the execution of the Licence and Management Agreement. All other services are to be performed within 10 days of the date of execution of the Licence and Management Agreement, and shall continue to be carried out throughout the Term of the Project.

38. The Project does not involve guaranteed returns or non-recourse financing. There are no risk reduction mechanisms or express or implied undertakings to reverse the transactions if tax deductions are not allowed by the Commissioner.

### **Fees**

39. Under the terms of the Licence and Management Agreements, a Grower will make the following payments per Woodlot:

- **The Application Moneys** are payable by each Grower on Application for the period from the Commencement Date to 30 June in the financial year in which execution of the Agreement takes place. The Application Moneys are made up of:
  - Management Fee of \$4,807. This fee contains an amount of \$55 relating to the provision of Neem and Melia Azedarach Seedlings;
  - Woodlot Rent of \$66;
  - Planting Fee of \$330. This fee contains an amount of \$33 for the planting of Neem and Melia Azedarach Seedlings;
  - Initial Insurance of \$33;
  - Irrigation Fee of \$264; and
  - Fee of \$1,000 for the purchase of Shares in ETA
- **Management Fees** in relation to the second year will be \$539. In subsequent years the Management Fees will be the amount due and payable in the proceeding year increased by the greater of 3% or the CPI in the preceding calendar year.
- **Rent Fees** in relation to the second year will be \$69.30. In subsequent years the Rent Fees will be the amount due and payable in the proceeding year increased by the greater of 3% or the CPI in the preceding calendar year.
- Subsequent to the first year **Insurance** for the Woodlot and Crop will be charged at the amount assessed by the

insurer. The Grower may take out additional insurance at the Growers expense.

- Growers who elect to have the Manager harvest and sell their Product are also required to pay the reasonable fees, costs and disbursements of **harvesting, marketing and selling** the Product as incurred by the Manager.

## Plantation Establishment

40. For Growers whose Licence and Management Agreements are executed on or before 22 June 2001 the Initial Period services to establish the plantation are to be completed by 30 June 2001. Where ETA receives Applications after 22 June the Licence the Management Agreement will not be executed until 1 July 2001. Where applications are processed on or after 1 July 2001 and prior to the closing date of the Prospectus all services required to establish the plantation, other than the planting of the Seedlings, are to be completed by 30 June 2002.

41. The Manager will not undertake any work on a Woodlot prior to the Woodlot being allotted to a Grower.

## Harvesting and Sale

42. The Grower has full right, title and interest in the trees and in the wood or any other product the trees may produce (clause 2.2), for the term of the Project. The Neem and Melia Azedarach will remain the property of the Lessor at the expiry of the Term of the Project.

43. When the Crop is ready to be harvested the Manager will notify the Grower in writing. Unless the Grower elects to undertake the harvest and sale of the Grower's Product, the Manager will arrange the harvest and sale of the Product for no less than the anticipated minimum price of sale specified in the harvest notice, or such other minimum price of sale as negotiated between the Growers and the Manager.

44. Growers will share in the proceeds of sale on a proportionate basis following the payment of the Management Fee, Rent Fee and any other amounts due and payable by the relevant Grower (clause 27 and 28 of the Constitution).

45. Harvesting and sale of the Product from the Neem and Melia Azedarach will commence in the third year of the Project. Thinning of the Sandalwood will be carried out in the eighth year of the Project with thinning of the Mahogany to be carried out in the ninth year of

the Project. The balance of the Sandalwood and Mahogany will be harvested in the sixteenth year of the Project.

46. If a Grower elects to harvest and sell the Product from the Grower's Woodlot (clauses 9.6 of the Licence and Management Agreement) the Grower must pay any unpaid Management Fees, charges and expenses on or before the Grower harvests its Woodlot.

### **Finance**

47. Growers can fund their investment in the Project themselves, or borrow from an independent lender.

48. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved, or become involved, in the provision of finance to Growers for the Project.

## **Ruling**

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### **Assessable Income**

49. A Grower's share of the gross sales proceeds from the Project, less any GST payable on these proceeds, will be assessable income under section 6-5. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.

50. Once harvested, a Grower's Product will be trading stock of the Grower. As a consequence, if Product are on hand at the end of the income year, the Grower will need to account for that trading stock in accordance with the trading stock provisions in Part 2-25 of ITAA 1997.

51. Each Grower will be notified by the Manager of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

### **Minimum subscription**

52. A Grower will not incur the fees shown in the Table(s) below before the minimum subscription for the Project is reached and the Grower's application to enter the Project is accepted. Under the Prospectus, a Grower's application will not be accepted and the Project will not proceed until the minimum subscription of 100 interests is achieved. Tax deductions are not allowable until these requirements are met.

### **Section 8-1**

#### **Deductions where a Grower invests in the Project on or before 22 June 2001 and is not registered nor required to be registered for GST**

53. A Grower may claim tax deductions in the Tables below where the Grower:

- participates in the Project on or before 22 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 39; and
- is not registered nor required to be registered for GST.

### **Section 8-1 – Prepaid fees**

54. Expenditure incurred by a Grower who participates in the Project is subject to the prepayment rules contained in sections

82KZME and 82KZMF. Therefore, a Grower who prepays fees that are otherwise allowable under section 8-1 **cannot** claim a tax deduction for the full amount of the fees in the year in which the expenditure is incurred unless it is 'excluded expenditure' (see note (ii) below).

55. The amount and timing of tax deductions allowable each year for such fees must be determined using the formula in subsection 82KZMF(1). In that formula, which is shown below, the 'eligible service period' means, generally, the period over which the services are to be provided.

Expenditure X  $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

56. Where Growers invest in this Project on or before 22 June 2001, Planting Fees are required to be prepaid. Where a number of interests are acquired and Planting Fees total \$1,000 or more in an income year, tax deductions allowable for Planting Fees (detailed at paragraph 39 in the Arrangement) must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples at paragraphs 122 and 123.

Fee Type	ITAA 1997 Section	Year ending 30/6/2001	Year ending 30/6/2002	Year ending 30/6/2003	Year ending 30/6/2004
<b>Management Fee</b>	8-1	\$4,752 – See Notes (i) and (iv) below	\$539 – See Notes (i) and (iv) below	\$539 – indexed by the greater of 3% or CPI – See Notes (i) and (iv) below	Previous years fee indexed by the greater of 3% or CPI – See Notes (i) and (iv) below
<b>Rent</b>	8-1	\$ 66 - See Notes (i) and (iv) below	\$69.30 - See Notes (i) and (iv) below	\$ 69.30 - indexed by the greater of 3% or CPI – See Notes (i) and (iv) below	Previous years fee indexed by the greater of 3% or CPI – See Notes (i) and (iv) below
<b>Planting Fee</b>	8-1	see note (ii) below	see note (ii) below		
<b>Insurance</b>	8-1	\$ 33 – See Notes (i) and (iv) below	Amount assessed by insurer – See Notes (i) and (iv) below	Amount assessed by insurer – See Notes (i) and (iv) below	Amount assessed by insurer – See Notes (i) and (iv) below
<b>Interest</b>		See Note (iii) below	See Note (iii) below	See Note (iii) below	See Note (iii) below

**Notes:**

- (i) Where a Grower incurs the management fees, the rent fees and the insurance fees as required by the Licence



and Management Agreement those fees are deductible in full in the year incurred.

- (ii) Where a Grower invests in 1 to 3 Woodlots and pays the Planting Fee on Application during the year ending 30 June 2001, the amount will be deductible in full as 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (See Example 3 at paragraph 123). Deductibility of amounts of \$1,000 or more, such as may occur where a Grower acquires a number of interests in the Project, will be determined using the formula in paragraph 55, (see example 2 at paragraph 122). Therefore, where a Grower invests in four or more Woodlots, the tax deduction for the prepaid Planting Fee **MUST** be determined using the formula shown in paragraph 55.
- (iii) The deductibility or otherwise of interest arising from agreements that Growers enter into to finance their participation in the Project is outside the scope of this Ruling. However, all Growers who enter into agreements to finance their participation in the Project should read carefully the discussion of the prepayment rules in paragraphs 112 to 114 below as those rules may be applicable if interest is prepaid.
- (iv) Where a Grower **chooses** to prepay fees beyond 13 months, sections 82KZME and 82KZMF will not apply to set the amount and timing of that Grower's tax deductions. Instead, unless the expenditure is 'excluded expenditure', the amount and timing of the tax deductions is determined under either subsection 82KZM(1) or subsection 82KZMD(2) (see paragraphs 104 to 108). To apportion the expenditure over the eligible service period, these provisions, which apply respectively to 'small business taxpayers' and taxpayers who are not 'small business taxpayers', effectively use the same formula as that shown above.

### **Tax deductions for capital expenses**

57. A Grower who invests in the Project on or before 22 June 2001 and who participates in the Project will also be entitled to the following tax deductions:

Fee type	ITAA 1997 section	Year ending 30/6/2001	Year ending 30/6/2002	Year ending 30/6/2003	Year ending 30/6/2004
Irrigation Costs	387-125	\$88 – see note (v) and (vi) below	\$88 – see note (v) and (vi) below	\$88 – see note (v) and (vi) below	Nil
Establishment of Horticultural Plants	387-165	Nil - see note (vii) below	Nil - see note (vii) below	\$6 - see note (vii) below	\$6 - see note (vii) below

**Notes:**

- (v) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.
- (vi) A tax offset is available to certain low income primary producers under section 388-55 in respect of expenditure incurred on facilities to conserve or convey water. This is an alternative to claiming deductions under section 387-125.
- (vii) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the Plantation for use in a horticultural business. The deduction is allowable when the trees, as horticultural plants, enter their first commercial season. If the Neem and Melia Azedarach have an 'effective life' for the purposes of section 387-185 of '30 years or more', this results in a write-off rate of rate of 7% prime cost. The Project's manager will inform Growers of when the Neem and Melia Azedarach enter their first commercial season.

**Deductions where a Grower invests in the Project on or after 23 June 2001 and is not registered nor required to be registered for GST**

58. A Grower may claim tax deductions in the Tables below where the Grower:

- participates in the Project on or after 23 June 2001 to carry on the business of agro-forestry;
- the Grower's Licence and Management Agreement is executed on or after 1 July 2001;

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- incurs the fees shown in paragraph 39; and
- is not registered nor required to be registered for GST.

59. In this Project, Planting is to be carried out within 7 months of the execution of the Licence and Management Agreement. Therefore, Planting Fees may be prepaid. Where the Planting Fee is prepaid and a number of interests are acquired and Planting Fees total \$1,000 or more in an income year, tax deductions allowable for Planting Fees (detailed at paragraph 39 in the Arrangement) must be calculated by applying the formula to the amount incurred each year by the Grower. The application of this method is shown in the Examples at paragraphs 122 and 123.

Fee Type	ITAA 1997 Section	Year ending 30/6/2001	Year ending 30/6/2002	Year ending 30/6/2003	Year ending 30/6/2004
<b>Management Fee</b>	8-1	Nil	\$4,752 – See Notes (i) & (iv) above	\$539 – See Notes (i) & (iv) above	\$539 – indexed by the greater of 3% or CPI – See Notes (i) & (iv) above
<b>Rent</b>	8-1	Nil	\$ 66 – See Notes (i) & (iv) above	\$69.30 - See Notes (i) & (iv) above	\$ 69.30 - indexed by the greater of 3% or CPI – See Notes (i) & (iv) above
<b>Planting</b>	8-1	Nil	see note (viii) below	see note (viii) below	
<b>Insurance</b>	8-1	Nil	\$ 33 – See Notes (i) & (iv) above	Amount assessed by insurer – See Notes (i) & (iv) above	Amount assessed by insurer – See Notes (i) & (iv) above
<b>Interest</b>		Nil	See Note (iii) above	See Note (iii) above	See Note (iii) above

**Notes:**

- (viii) Where a Grower invests in 1 to 3 Woodlots and pays the Planting Fee on Application during the year ending 30 June 2002, the amount will be deductible in full as 'excluded expenditure'. Excluded expenditure is an 'exception' to the prepayment rules and is deductible in full in the year in which it is incurred (See Example 3 at paragraph 123). Deductibility of amounts of \$1,000 or more, such as may occur where a Grower acquires a number of interests in the Project, will be determined using the formula in paragraph 55 (see Example 2 in paragraph 122). Therefore, where a Grower invests in

four or more Woodlots, the tax deduction for the prepaid Planting Fee **MUST** be determined using the formula shown in paragraph 55.

### **Tax deductions for capital expenses**

60. A Grower who invests in the Project on or after 23 June 2001 and who participates in the Project will also be entitled to the following tax deductions:

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year ending 30/6/2001</b>	<b>Year ending 30/6/2002</b>	<b>Year ending 30/6/2003</b>	<b>Year ending 30/6/2004</b>
Irrigation Costs	387-125	Nil – see note (ix) below	\$88 – see note (ix) below	\$88 – see note (ix) below	\$88 – see note (ix) below
Seedling and Planting Fees	387-165	Nil - see note (x) below	Nil - see note (x) below	\$6 - see note (x) below	\$6 - see note (x) below

### **Notes:**

- (ix) A deduction is allowable under section 387-125 for capital expenditure incurred for acquisition and installation of the irrigation system. The deduction is calculated on the basis of one third of the capital expenditure in the year in which the expenditure is incurred, and one third in each of the next 2 years of income.
- (x) A deduction is allowable under section 387-165 for capital expenditure incurred for the acquisition and establishment of the Plantation for use in a horticultural business. The deduction is allowable when the Neem and Melia Azedarach, as horticultural plants, enter their first commercial season. If the Neem and Melia Azedarach have an 'effective life' for the purposes of section 387-185 of '30 years or more', this results in a write-off rate of rate of 7% prime cost. The Project's manager will inform Growers of when the Neem and Melia Azedarach enter their first commercial season.

### **Deductions where a Grower invests in the Project on or before 22 June 2001 and is registered or is required to be registered for GST**

61. Where a Grower who is registered or is required to be registered for GST:

- participates in the Project on or before 22 June 2001 to carry on the business of afforestation;
- incurs the fees shown in paragraph 39; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables in paragraphs 56 and 57 above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 121.

## **Deductions where a Grower, invests in the Project on or after 23 June 2001 and is registered or is required to be registered for GST**

62. Where a Grower who is registered or is required to be registered for GST:

- participates in the Project on or after 23 June 2001 to carry on the business of afforestation;
- the Grower's Licence and Management Agreement is executed on or after 1 July 2001;
- incurs the fees shown in paragraph 39; and
- is entitled to an input tax credit for the fees,

then the tax deductions shown in the Tables in paragraphs 59 and 60 above will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). See Example 1 at paragraph 121.

## **Division 35 – Deferral of losses from non-commercial business activities**

### **Section 35-55 – Commissioner's discretion**

63. For a Grower who is an individual and who enters the Project during the year ended 30 June 2001 or 30 June 2002, the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for the income years ending 30 June 2001 to 30 June 2005 for Growers who invest in the project on or before 22 June 2001 and for the income year ending 30 June 2002 to 30 June 2005 for Growers who invest in the project on or after 23 June 2001 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

64. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- a Grower's business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the 'Exception' in subsection 35-10(4) applies (see paragraph 86 in the Explanations part of this ruling, below).

65. Where either the Grower's business activity satisfies one of the objective tests, the discretion in subsection 35-55(1) is exercised, or the Exception in subsection 35-10(4) applies, section 35-10 will not apply. This means that a Grower will not be required to defer any deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any 'loss' from that activity, to a later year. Instead, this 'loss' can be offset against other assessable income for the year in which it arises.

66. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the Commissioner's decision to exercise the discretion in subsection 35-55(1) as an indication that the Tax Office sanctions or guarantees the Project or the product to be a commercially viable investment. An assessment of the Project or the product from this perspective has not been made.

#### **Sections 82KZM, 82KZMB – 82KZMD, 82KZME, 82KZMF, 82KL and Part IVA**

67. For a Grower who participates in the Project and incurs expenditure as required by the Licence and Management Agreement the following provisions of the ITAA 1936 have application as indicated:

- expenditure by the Grower on Management, Rent and Insurance fees does not fall within the scope of section 82KZM (but see paragraphs 101 to 108);
- expenditure by the Grower on Management, Rent and Insurance fees does not fall within the scope of sections 82KZMB-82KZMD (but see paragraphs 101 to 108);
- expenditure by the Grower on Management, Rent and Insurance fees does not fall within the scope of sections 82KZME and 82KZMF (but see paragraphs 101 to 108);
- section 82KL does not apply to deny the deductions otherwise allowable; and

- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## Explanations

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### Assessable income

68. All sales made from Product will be ordinary income of the Grower under the general provisions of section 6-5 of ITAA 1997.

69. Once harvested, a Grower's Product will be trading stock of the Grower. As a consequence Product on hand at the end of the income year will need to be accounted for in accordance with the trading stock provisions in Part 2-25 of ITAA 1997, and included in assessable income.

70. Each Grower will be notified by the Manager of the respective amounts to be brought to account in proportion to their total holding in the Project, in accordance with Part 2-25 and Taxation Ruling IT 2001.

### Section 8-1

71. Consideration of whether the management fees and the rent fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and
- where all that happens in a year of income is that a taxpayer contractually commits themselves to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced and, hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

**Is the Grower carrying on a business?**

72. An agro-forestry scheme can constitute the carrying on of a business. Where there is a business, or a future business, the proceeds from the sale of Product each year from Woodlots comprising the Project will constitute gross assessable income in their own right. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will be the planting, tending and maintaining of the Plantation and harvesting of the Product each year from the Woodlot. Generally, a Grower will be carrying on a business of agro-forestry where:

- the Grower has an identifiable interest in the Woodlot coupled with a right to harvest and sell the Product each year from the trees;
- the agro-forestry activities are carried out on the Grower's behalf; and
- the weight and influence of the general indicators of a business as used by the Courts point to the carrying on of a business.

73. For this Project, Growers have rights under the Licence and Management Agreement in the form of a licence over an identifiable area of land consistent with the intention to carry on a business of agro-forestry. Under the Licence and Management Agreement, Growers engage the Project Manager to acquire Sandalwood, Mahogany, Neem and Melia Azedarach seedlings and plant out the seedlings on the licensed land. Under the same agreement Growers appoint the Manager to provide services such as cultivating, tending, replanting and otherwise caring for the trees as and when required according to good silvicultural practice. Growers are considered to have control of their operations. The specific cost of these services provided in the First Year will be \$5,500.

74. The Licence and Management Agreement gives Growers an identifiable interest in specific Seedlings and Crop and a legal interest in the leased land. Growers have the right to personally harvest and sell the Product attributed to their Woodlot or they may appoint the Manager to arrange the harvest and sale of the Product for them. The Project documentation contemplates that Growers will have a continuing interest in the Seedlings and trees suitable for the harvesting of either wood or any other Product the trees may produce and the Crop which is harvested or harvestable from the Woodlot.

75. Growers have the right to use the land in question for agro-forestry purposes and to have the Project Manager come onto the land



to carry out its obligations under the Licence and Management Agreement. The Growers' degree of control over the Project Manager as evidenced by the Licence and Management Agreement is sufficient. Under the Project, Growers are entitled to receive regular progress reports on the Project Manager's activities. Growers are able to terminate arrangements with the Project Manager in certain instances, such as cases of default or neglect. The agro-forestry activities described in the Licence and Management Agreement are carried out on the Growers' behalf.

76. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators. Growers to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Growers, i.e., a 'profit' in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

77. Growers will engage the professional services of a manager with appropriate credentials. There is a means to identify which Product each Grower has an interest in. These services are based on accepted silvicultural practices and are of the type ordinarily found in Sandalwood, Mahogany, Neem and Melia Azedarach growing ventures that would commonly be said to be businesses.

78. Growers have a continuing interest in the trees grown on the Woodlots. The agro-forestry activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. The Grower's agro-forestry activities will constitute the carrying on of a business.

79. The rent fees and management fees associated with the agro-forestry activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which income (from the regular sale of Product) is to be gained from the business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. There is no capital component of the management fee. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

### **Expenditure of a capital nature**

80. Any part of the expenditure of a Grower entering into a business of agro-forestry that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature

and will not be an allowable deduction under section 8-1. In this Project, the costs of irrigation and the establishment of horticultural plants are considered to be capital in nature. The fees for these expenditures are not deductible under section 8-1. However, this expenditure falls for consideration under specific write-off provisions of the ITAA 1997.

### **Subdivision 387-B – Irrigation expenditure**

81. Section 387-125 allows a taxpayer, who is carrying on a business of primary production on land in Australia, to claim a deduction for capital expenditure on conserving or conveying water. The deduction is allowed over a three-year period and applies to plant or a structural improvement primarily or principally used for the purpose of conserving or conveying water for use in a primary production business. Irrigation systems of the kind proposed would be covered by this Subdivision.

82. As the taxpayer who can claim the deduction does not have to actually own the land but can be a tenant, a lessee or Licensee who is conducting a primary production business on land in Australia, a deduction would be available to a Grower in the Project at a rate of 33.3 per cent per annum for the cost of the irrigation system.

83. However, a deduction under section 387-125 is denied where the Grower is entitled to claim a water facility tax offset under section 388-55 and chooses to do so. A Grower can only choose a water facility tax offset where:

- had the Grower chosen a deduction instead of the tax offset, the Grower's taxable income for the income year would have been \$20,000 or less; and
- the expenditure is incurred before the end of the 2000-01 income year.

A Grower who invests on or after 23 June 2001 is not entitled to claim a water facility offset under section 388-55 as the expenditure is not incurred before the end of the 2000-01 income year.

### **Subdivision 387-C - Horticultural provisions**

84. Section 387-165 allows capital expenditure on establishing horticultural plants owned and used, or held ready for use, in Australia in a business of horticulture to be written off for tax purposes. A lessee or Licensee of land carrying on a business of horticulture is taken to own the plants growing on that land rather than the actual owner of the land (section 387-210).

85. Under this Subdivision, if the effective life of the plant is less than three years, the expenditure can be written off in full. If the effective life of the plant is more than three years, an annual deduction is allowable on a prime cost basis during the plant's maximum write-off period. The period starts from the time the plant enters its first commercial season. The write-off rate is detailed in section 387-185. For plants, such as the Neem and Melia Azedarach in this Project, with an effective life of '30 years or more', that rate is 7%.

### **Division 35 – Deferral of losses from non-commercial business activities**

86. Under the rule in subsection 35-10(2) a deduction for a loss incurred by an individual (including an individual in a general law partnership) from certain business activities will not be allowable in an income year unless:

- the 'Exception' in subsection 35-10(4) applies;
- one of four objective tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the objective tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

87. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

88. Under the loss deferral rule in subsection 35-10(2) the relevant loss is not able to be taken into account in the calculation of taxable income in the year that loss arose. Instead, in a later year it may be offset against any income from the same or similar business activity, or, if one of the objective tests is passed, or the Commissioner's discretion exercised, against other income.

89. For the purposes of applying the objective tests, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'Exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

90. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year) (section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

91. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum investment of one interest in the Project during the years ended 30 June 2001 or 30 June 2002 is unlikely to pass one of the objective tests until the income year ended 30 June 2008. Growers who acquire more than one interest in the Project may, however, pass one of the tests in an earlier income year.

92. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

93. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, for an individual Grower who acquires an interest(s) in the Project, the Commissioner will decide that it would be unreasonable not to exercise the second arm of the discretion in paragraph 35-55(1)(b) until 30 June 2005.

94. The second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on; and
- (ii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

95. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). Therefore, if the Project fails to be carried on during the income years specified above (see paragraph 63), in the manner described in the Arrangement (see paragraphs 15 to 48), the Commissioner's

discretion will not have been exercised because one of the key conditions in paragraph 35-55(1)(b) will not have been satisfied.

96. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent experts and additional evidence provided with the application by the Manager;
- objective information relating to the agro-forestry industry which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Manager.

## **Sections 82KZME and 82 KZMF – prepaid planting fees**

97. Expenditure of \$297 prepaid by Growers for Planting Fees meets the requirements of subsections 82KZME(1) and (2) and the expenditures are incurred under an ‘agreement’ as described in subsection 82KZME(3). Therefore, unless one of the exceptions to section 82KZME applies to the expenditures, the amount and timing of tax deductions for those expenditures are determined under section 82KZMF.

98. In relation to the requirements of subsection 82KZME(1) and (2), the prepaid Planting fees incurred by a Grower who participates in the Project:

- are otherwise deductible under section 8-1; and
- have ‘eligible service periods’ (for each of the fees) that end not more than 13 months after the Grower incurs the expenditure; and
- are incurred in return for the doing of a thing under the agreement that is not wholly to be done within the expenditure year.

The ‘eligible service period’ (defined in subsections 82KZL(1)) means, generally, the period over which the services are to be provided.

99. In relation to an ‘agreement’ referred to in subsection 82KZME(3), the Project is an ‘agreement’ (this being a broad concept under subsection 82KZME(4)), where, during the term of this Product Ruling:

- the Grower’s allowable deductions attributable to the Project for each expenditure year exceeds the Grower’s

assessable income from the Project (if any) for the expenditure year; and

- the Grower does not have day-to-day control over the operation of the Project; and
- there is more than one Grower participating in the Project.

100. The prepaid Planting Fees, being amounts of less than \$1,000 in each expenditure year, constitute 'excluded expenditure' as defined in subsection 82KZL(1). Under Exception 3 (subsection 82KZME(7)) 'excluded expenditure' is not subject to section 82KZMF and is, therefore, deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of prepaid lease fees is \$1,000 or more, then the deduction allowable for those amounts will also be subject to apportionment under section 82KZMF.

#### **Prepayments provisions - sections 82KZM, 82KZMA - 82KZMD and 82KZME - 82KZMF**

101. The prepayments provisions of the ITAA 1936 operate to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that is not wholly done within the same year of income as the year in which the expenditure is incurred.

102. In this Project, the Management Fee of \$4,752, the Rent Fee of \$66 and the Insurance Fee of \$33 per Woodlot will be incurred on execution of the Licence and Management Agreement. The Management Fee and Rent Fee are charged for providing management services and licensing land to a Grower by 30 June of the year of execution of the Agreements. In particular, the Management Fee is expressly stated to be for a number of specified services. No explicit conclusion can be drawn from the description of the arrangement that the Management Fee has been inflated to result in reduced fees being payable for subsequent years.

103. There is also no evidence that might suggest the management services covered by the fee could not be provided within the same year of income as the expenditure in question is incurred. Thus, for the purposes of this Ruling, it can be accepted that no part of the initial fee is for the Manager doing 'things' that are not to be wholly done within the year of income of the fee being incurred. On this basis, provided a Grower incurs expenditure as required by the agreements as set out in paragraph 39 for Management Fees, Rent

Fees and Insurance Fees then the basic precondition for the operation of the prepayment provisions is not satisfied and fees will be deductible in the year in which they are incurred.

**Growers who choose to pay fees for a period in excess of that required by the Project's agreements**

104. Although not required under the Licence and Management Agreement, a Grower participating in the Project may choose to prepay fees for a number of years. Where this occurs, contrary to the conclusion reached in paragraph 102 above, the prepayments provisions of the ITAA 1936 will operate to apportion the expenditure and allow an income tax deduction over the period that the prepaid benefits are provided.

105. The amount and timing of tax deductions for any prepaid Management Fees or prepaid Rent Fees otherwise deductible under section 8-1 will depend upon when the respective amounts are incurred and what the 'eligible service period' is, as defined in subsection 82KZL(1), in relation to these amounts. The 'eligible service period' means, generally, the period over which the services are to be provided. The relevant provision of the ITAA 1936 will depend on a number of factors including the amount and timing of the prepayment and, where the 'eligible service period' exceeds 13 months, whether the Grower is a 'small business taxpayer'.

106. Where a Grower participating in this Project incurs expenditure in respect of an eligible service period that ends 13 months or less from the time the expenditure was incurred, but also in respect of the doing of a thing not to be wholly done within the income year in which that expenditure has been incurred, and the other tests in section 82KZME are met, then section 82KZMF will apply in the manner set out in the formula below.

Expenditure X  $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

In the formula, the 'eligible service period' means, generally, the period to which the services are to be provided.

107. Where a Grower participating in this Project incurs expenditure in respect of a period that ends more than 13 months after that expenditure has been incurred, then section 82KZM will apply if the Grower is a 'small business taxpayer' or section 82KZMD if the Grower is not a 'small business taxpayer'. For a 'small business taxpayer' (see paragraphs 109 to 111), the amount and timing of the allowable deductions will then be calculated using the formula in subsection 82KZM(1) and for non-small business taxpayers using the formula in subsection 82KZMD(2). Both formulae are the same, or

effectively the same as that shown in paragraph 106 above, concerning section 82KZMF.

108. A prepaid management fee and/or a prepaid licence fee of less than \$1,000 incurred in an expenditure year is 'excluded expenditure' as defined in subsection 82KZL(1). Subsections 82KZM(1), 82KZME(7) and 82KZMA(4) all provide that 'excluded expenditure' is an exception to the prepayment rules discussed above. Therefore, a prepaid fee of less than \$1,000 is deductible in full in the year in which it is incurred. However, where a Grower acquires more than one interest in the Project and the quantum of a prepaid management fee or a prepaid lease fee is \$1,000 or more, then the amount and timing of the deduction allowable must be determined using the formula shown above.

#### **Subdivision 960-Q - Small business taxpayers**

109. A 'small business taxpayer' is defined in section 960-335 of the ITAA 1997 as a taxpayer who is carrying on a business and either their 'average turnover' for the year is less than \$1,000,000 or their turnover recalculated under section 960-350 is less than \$1,000,000.

110. 'Average turnover' is determined under section 960-340 by reference to the average of the taxpayer's 'group turnover'. The group turnover is the sum of the 'value of business supplies' made by the taxpayer and entities connected with the taxpayer during the year (section 960-345).

111. Whether a Grower is a 'small business taxpayer' depends upon the circumstances of each Grower and is beyond the scope of this Product Ruling. It is the responsibility of each Grower to determine whether or not they are within the definition of a 'small business taxpayer'.

#### **Interest deductibility**

112. The deductibility of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

113. While the terms of any finance agreement entered into between relevant Growers and such financiers are subject to commercial negotiation, those agreements may require interest to be prepaid. Under the prepayment rules contained in sections 82KZME, 'agreement' (defined in subsection 82KZME(4)) is a broad concept and includes all activities that relate to the agreement including those that give rise to deductions or assessable income. It will encompass



activities not described in the Arrangement or otherwise dealt with in the Product Ruling, such as a loan to finance participation in the Project.

114. Therefore, unless the prepaid interest is ‘excluded expenditure’, where such a loan facility requires interest to be prepaid and the requirements of section 82KZME are met, relevant Growers will be required to use the formula in subsection 82KZMF(1) to determine any tax deduction that may be allowable. Where a prepayment is for more than 13 months, any tax deduction that may be allowable must be determined under section 82KZM (for a ‘small business taxpayer’) or section 82KZMD (for a taxpayer who is not a ‘small business taxpayer’). The relevant formula is the same, or effectively the same as that shown above in paragraph 106 above.

### **Section 82KL - recouped expenditure**

115. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the ‘additional benefit’ plus the ‘expected tax saving’ in relation to that expenditure equals or exceeds the ‘eligible relevant expenditure’.

116. ‘Additional benefit’ (see the definition of ‘additional benefit’ at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The ‘expected tax saving’ is essentially the tax saved if a deduction is allowed for the relevant expenditure.

117. Section 82KL’s operation depends, among other things, on the identification of a certain quantum of ‘additional benefits’. Insufficient ‘additional benefits’ will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

### **Part IVA - general tax avoidance provisions**

118. For Part IVA to apply there must be a ‘scheme’ (section 177A), a ‘tax benefit’ (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

119. The Exotic Timbers of Australia NT3 Project will be a ‘scheme’. A Grower will obtain a ‘tax benefit’ from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 53 to 60 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be

entered into or carried out with the dominant purpose of obtaining this tax benefit.

120. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of Product. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or, if any parties are not at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

## **Examples**

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### **Example 1 – Entitlement to 'input tax credit'**

121. Margaret, who is registered for GST, invests in the Green Circle Bluegums Project. The management fees are payable on 1 July each year for management services to be provided over the following 12 months. On 1 July 2000 Margaret pays her first year's management fees of \$5,500 and is eligible to claim a tax deduction for the fees in the income year ended 30 June 2001. The extent of her deduction for the management fees, however, is reduced by the amount of any 'input tax credit' to which she is entitled. The Project Manager provides Margaret with a 'tax invoice' showing its ABN and the price of the taxable supply for management services as \$5,500. Using the details shown on the valid tax invoice, Margaret calculates her input tax credit as:

$$\frac{1}{11} \times \$5,500 = \$500$$

Therefore, the tax deduction for management fees that she can claim in her income tax return for the year ended 30 June 2001 is \$5,000 (\$5,500 *less* \$500).

### **Example 2 – Prepaid expenditure and the apportionment of fees**

122. Murray decides to invest in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are

payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Project Manager with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2001 the Project Manager informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray, who is not registered nor required to be registered for GST calculates his tax deduction for management fees for the **2001 income year** as follows:

Management fee x  $\frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2001 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2001 income year).

In the **2002 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,643** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2002 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2002 income year).

**\$4,643 + \$85 = \$4,728** (The sum of these two amounts is Murray's total tax deduction for management fees in 2002).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

### **Example 3 – Apportionment of fees where there is a contractual 'eligible service period' and the fees include expenditure that is 'excluded expenditure'**

123. On 1 June 2001 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision

of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2001.

Kevin, who is not registered nor required to be registered for GST calculates his tax deduction for management fees and the lease fee for the **2001 income year** as follows:

*Management fee*

Even though he paid the \$3,600 in the 2001 income year, because there are no 'days of eligible service period' in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2001.

*Lease fee*

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2001.

In the **2002 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\begin{array}{r} \$3,600 \quad \times \quad \frac{365}{365} \\ \hline \end{array}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2001 income year but not deductible until the 2002 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

## **Detailed contents list**

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## **Commissioner of Taxation**

20 June 2001

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*Previous draft:*  
Not previously issued in draft form

### *Related Rulings/Determinations:*

TR 97/11; TR 97/16; PR 1999/95;  
TR 92/1; TR 92/20; TD 93/34;  
TR 98/22; IT 2001

### *Subject references:*

- carrying on a business

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- commencement of business
  - fee expenses
  - horticulture
  - irrigation expenses
  - management fees expenses
  - primary production
  - primary production expenses
  - primary production income
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  - product rulings
  - public rulings
  - schemes and shams
  - tax administration
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  - tax benefits under tax avoidance schemes
  - tax shelters
  - tax shelters project
- ITAA 1997 387-125
  - ITAA 1997 387-C
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  - ITAA 1997 387-185
  - ITAA 1997 387-210
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